

EXECUTIVE CHAMBERS

HONOLULU

May 3, 2004

STATEMENT OF OBJECTIONS TO HOUSE BILL NO. 1043

Honorable Members
Twenty-Second Legislature
State of Hawaii

Pursuant to Section 16 of Article III of the Constitution of the State of Hawaii, I am returning herewith, without my approval, House Bill No. 1043, entitled "A Bill for an Act Relating to Making Appropriations for Salary Increases for Public Employees."

The purpose of this bill is to fund collective bargaining cost items as a result of binding arbitration with collective bargaining units (2), (3), (4), (6), (8), and (13), as well as salary increases and other cost adjustments for their excluded counterparts.

As outlined in my April 7, 2004 Message to the Legislature, the HGEA Arbitration Award will have serious, long-term adverse impacts on the financial well-being of the State of Hawaii.

The HGEA Arbitration Award amounts to a 7.8 percent pay increase in fiscal year 2005, at a cost of \$32.2 million in fiscal year 2005 and \$53.8 million in fiscal year 2006. Over the next five years this arbitrated award would create a \$248.9 million I.O.U. that taxpayers would have to pay. This total is the best-case scenario, since it assumes no new pay raises for HGEA members over the next four years.

Salary increases of this magnitude will create sustained budget deficits starting in fiscal year 2006 and

STATEMENT OF OBJECTIONS
HOUSE BILL NO. 1043
Page 2

cause serious cuts in government services. These deficits will occur at a time when the State is facing a \$165 million jump in debt service payments and a \$57 million increase in retirement system contributions. As I have repeatedly emphasized, it is not a matter of whether the State can afford the HGEA pay raises this year. It is a matter of what the State can afford next year and in the years to come.

To compound the problem, the Arbitration Panel coupled this significant increase in wages with a reduction in productivity by granting employees hired after July 1, 2001 nine more days of vacation and six more days of sick leave beginning July 1, 2004. I have not included this as a cost item. However, the unrebutted evidence produced at the arbitration hearings was that this vacation and sick pay increase equates to an \$8.9 million loss in productivity for the second year of the contract and an increasing loss of productivity each year thereafter.

Succinctly put, the State of Hawaii cannot afford the HGEA Arbitration Award. Raiding special funds, emergency funds, deferring pay days or diverting monies from the Employees Retirement System to pay for wage settlements are reactions that have proven fundamentally detrimental to the State's future financial well-being. The overall public interest is not served if a disproportionate share of the State's limited discretionary resources is used to fund collective bargaining costs, leaving other critical public programs unfunded or underfunded.

STATEMENT OF OBJECTIONS
HOUSE BILL NO. 1043
Page 3

In addition to the detrimental fiscal implications of enacting House Bill No. 1043, the passage of this bill was based on factual assumptions in the HGEA Arbitration Award that were flawed. First, the Arbitration Panel incorrectly assumed that the State had a balance of \$972 million in unrestricted funds at the end of fiscal year 2003. This figure represents the net of \$1.065 billion in assets from the Airports Fund, the Harbors Fund, and the Unemployment Compensation Fund, minus \$92.9 million from all other governmental activities. Balances in the airport, harbors, and unemployment funds must, by law, be used for the specific purposes named. It is neither fiscally or legally possible to use these monies for wage settlements.

Second, the Arbitration Panel incorrectly used the State of Hawaii Comprehensive Annual Financial Report (CAFR) to estimate available funds at the end of fiscal year 2003. The State's financial reports are published on an accrual basis. This means the end of year figures in 2003 included tax revenues generated in fiscal year 2003 but not collected until fiscal year 2004. The figures also included expenditure liabilities (such as Medicaid and payroll) incurred in fiscal year 2003 but not paid out until fiscal year 2004. To use the CAFR, which is a backward looking document, to project what funds may be available in a future year, is inaccurate and misleading.

Third, the Arbitration Panel referenced the State's good credit rating to conclude the State could pay for this award. The fact of the matter is credit rating

STATEMENT OF OBJECTIONS
HOUSE BILL NO. 1043
Page 4

agencies consider a wide variety of factors in their analysis of a jurisdiction's creditworthiness. The credit rating process examines the State's economy, revenue collections, and the Administration's commitment to fiscal discipline. The willingness of the State to control expenditures during periods of slower economic growth, allowing the State to carryover sufficient financial reserves, also contributed to its positive credit rating. The rating is performed to assure bondholders that the State is able to pay its existing debts, not to indicate the State's ability to pay for future salary increases.

Finally, the HGEA Arbitration Award is legally flawed. As pointed out in my April 7, 2004 transmittal to the Legislature, the award failed to adequately explain how it took into account at least five factors set forth in sections 89-11(f) of the Hawaii Revised Statutes. These factors include failure to stay within the lawful authority of the employer, failure to include the interests and welfare of the public, failure to consider the State's ability to pay, failure to use proper wage comparisons, and failure to give proper consideration to the overall compensation package when making the award.

In consideration of the exercise of my legal and fiduciary responsibility to the State, I am returning House Bill No. 1043 without my approval.

Respectfully,

LINDA LINGLE
Governor of Hawaii